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IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

SOUTH CENTRAL BELL TELEPHONE COMPANY, *et al.*,
Petitioners,

v.

STATE OF ALABAMA and
STATE DEPARTMENT OF REVENUE,
Respondents.

On Writ of Certiorari to the Supreme Court of Alabama

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of the Supreme Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of petitioners.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute")

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[1] Pursuant to Rule 37.6, *amicus* TEI states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Tax Executives Institute has received the written consents of the Petitioners and Respondents to the filing of this brief; those consents have been filed with the Clerk of the Court.

is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 5,000 members who represent nearly 2,800 of the leading busineses in the United States and Canada, nearly all of which are engaged in interstate commerce.

The members of the Institute represent a cross-section of the business community in North America. The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the Nation, to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and to vindicating the due process and Commerce Clause rights of business taxpayers.

Tax Executives Institute's members have a vital interest in the resolution of this case, which involves the State of Alabama's franchise tax. Even those members whose companies are not doing business in Alabama are, almost without exception, engaged in interstate commerce. Consequently, they benefit from, and are entitled to, the protection afforded by the Commerce Clause and Due Process Clause of the U.S. Constitution. The potential diminution of that protection portended by the Alabama Supreme Court's decision is of material concern to the Institute and all its members. Because TEI members and the businesses by which they are employed will be materially affected by the Court's decision, the Institute has a special interest in the outcome of this case.

SUMMARY OF ARGUMENT

This case involves the questions whether Alabama's theory of *res judicata* operates to deny taxpayers due process and, further, whether the State's franchise tax on out-of-state corporations contravenes the Commerce Clause of the Constitution. U.S. CONST. amend. XIV,

§ 1; U.S. CONST. art. I, § 8, cl. 3. The record shows that, by improperly invoking *res judicata*, the Alabama courts unconstitutionally denied the taxpayers their due process rights. It also shows that the State of Alabama has been discriminating against foreign corporations for more than eight decades.

The Alabama trial court's theory of *res judicata* squarely contradicts the Court's 1996 decision in *Richards v. Jefferson County*, 116 S. Ct. 1761 (1996). There, the Court held that the State's interpretation of *res judicata* "deprived [the taxpayers] of the due process of law guaranteed by the Fourteenth Amendment." *Id.* at 1765. In this case, the trial court perpetuated the Alabama Supreme Court's error in *Richards*. Under the trial court's rationale, businesses would be forced to follow hundreds, if not thousands, of state tax cases—assuming, that is, that an adequate, time-sensitive tracking system even existed. Equally troubling, the result below implies that taxpayers may have to intervene in any case that *might* tangentially affect their interests in order to preserve their rights. As an organization dedicated to minimizing the costs and burdens of tax administration, *amicus* TEI is troubled that such a suggestion might be taken seriously. The courts, too, should be concerned about the deluge of protective interventions that would assuredly thwart the goal of judicial economy. Finally, *amicus* TEI is concerned about the imposition of a more stringent standard for "large and sophisticated" taxpayers that employ "well known" counsel and the strain that application of such a standard would impose on both courts and taxpayers.

The doctrine of *res judicata* is intended to promote finality and judicial economy by precluding the relitigation of issues where the parties in interest had previously enjoyed "their day in court." As the Court explained in *Richards*, "to contend that the plaintiffs in [the prior litigation] somehow represented petitioners, let alone represented them in a constitutionally adequate manner,

would be 'to attribute to them a power that it cannot be said that they had assumed to exercise.'" 116 S. Ct. at 1768 (quoting *Hansberry v. Lee*, 311 U.S. 32, 46 (1940)). Furthermore, the doctrine does not apply when superseding decisions of this country's highest court have repudiated the basis for the original decision. *Commissioner v. Sunnen*, 333 U.S. 591, 599 (1948) (federal tax case). The decision below represents an extreme application of *res judicata* in violation of the Due Process Clause and should be reversed.

Moreover, the decision below also contravenes the Commerce Clause of the Constitution. The "fundamental purpose of the Clause is to assure that there be free trade among the several States." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 335 (1977). To effectuate this purpose, a state taxing scheme will be invalidated if it imposes a higher tax burden on foreign, or out-of-state, corporations than on domestic corporations engaged in comparable activity. *Id.* at 329. In *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), this Court held that the presence of either a discriminatory purpose or a discriminatory effect compels a finding of proscribed "economic protectionism." *Id.* at 272-73.

In contrast to Alabama's domestic franchise tax (which is based on the par value of the corporation's outstanding stock), the State's foreign tax base includes not only that value, but also surplus, retained earnings, long-term and related-party debt, and accelerated depreciation. As a result of the different tax bases, foreign corporations doing business in Alabama are subject to a much higher level of taxation than are similarly situated domestic corporations. For domestic corporations, payment of more than a nominal amount of franchise tax is effectively optional, whereas foreign corporations do not enjoy such a choice. That difference cannot withstand scrutiny.

Alabama's discrimination against out-of-state taxpayers is indisputable. Indeed, not one Alabama judge who reviewed the evidence in this case held that the State's franchise tax scheme is constitutional. That the tax does not pass constitutional muster was made manifest by this Court's decision three terms ago in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), in which a North Carolina intangibles tax on the fair market value of stock owned by state residents was examined. Under the state statute, residents owning stock in a corporation that earned income solely within the state paid no intangibles tax, whereas residents with stock of foreign corporations having no in-state activities paid the full amount. Because the tax was computed on a different net base depending on the corporation's in-state activities, it facially discriminated against interstate commerce. 516 U.S. at 327-28, 333 & n.3.

In light of the *Fulton Corp.* case, the Alabama Supreme Court did not hold that the tax is not discriminatory. Rather, the state supreme court simply affirmed a decision where the trial court conceded the tax's discriminatory nature but denied taxpayers' constitutional right to contest it on grounds of *res judicata*—specifically, the Alabama Supreme Court's prior decision in *White v. Reynolds Metals Co.*, 558 So.2d 373 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990). Subsequent decisions of this Court demonstrate unequivocally, however, that the Alabama Supreme Court's 1989 decision in *Reynolds Metals* was wrong. *See Fulton Corp.*, 516 U.S. at 333 (1996 decision holding North Carolina's tax on stock is unconstitutional); *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 104 (1994) (1994 decision holding that the failure to identify a specific charge on intrastate commerce equal to or exceeding charge on interstate commerce is fatal to state's claim). What is now clear—if there was ever any doubt—is that the Commerce Clause proscribes any and all discrimination, regardless of intent.

Faced with the choice of crafting a meaningful remedy that would be neither easy to implement nor inexpensive or of conjuring up a justification for denying the teachings of both *Fulton Corp.* and *Richards*, the Alabama court embraced the latter course. Viewed in isolation, the decision is troubling for it suggests a willingness to vitiate the constitutional rights of interstate businesses in order to preserve a discriminatory taxing scheme. Viewed more broadly, this case represents just another step in States' sorry efforts to avoid paying taxpayers what they are rightly owed—the refund of an unconstitutional tax.

In this case, Alabama distended *res judicata* to deny taxpayers a refund of illegally extracted monies. If Alabama prevails here, state courts will become a place where the rules no longer matter. If taxpayers win by the rules, too many States may consider themselves free to change them. Such a result cannot be permitted. The decision below should be reversed.

ARGUMENT

I.

The questions presented here are (1) whether the State of Alabama's interpretation of the doctrine of *res judicata* operates to deny the taxpayers due process and (2) whether the State's franchise tax on out-of-state corporations contravenes the Commerce Clause of the Constitution. U.S. CONST. amend. XIV, § 1; U.S. CONST. art. I, § 8, cl. 3. The overarching issue, however, is much more straightforward: Whether the States should be permitted to erect one legal artifice after another to deny taxpayers their constitutional rights and extract from them impermissible taxes. The record shows that the State's courts have engaged in adjudicatory sleight of hand to prevent taxpayers from litigating the constitutionality of the taxing scheme and hence to shield Alabama's violation of the Commerce Clause from review and correction.

Their efforts, which come on the heels of corresponding efforts by other States concerning other taxes, constitute a violation of the Fourteenth Amendment's Due Process Clause and must fail.

Foreign corporations doing business within the State of Alabama are subject to a franchise tax based on "the actual amount of . . . capital employed" in the State. ALA. CODE § 40-14-41(a) (1993) (App. G at 91a);[2] *see* ALA. CONST. art. XII, § 232 (1901). The Alabama Code defines "capital" to include not only the par value (or stated value) of the foreign corporation's outstanding capital stock, but also its surplus and undivided profits, long-term debt, certain related-party debt, and accelerated depreciation. ALA. CODE § 40-14-41(b) (1993) (App. G at 91a-92a). Capital employed in Alabama is determined by apportioning total capital to Alabama on the basis of a three-factor formula (property, payroll, and sales). ALA. ADMIN. CODE r. 810-2-3-.11 (1991) (App. G at 106a).

Domestic corporations are also subject to an annual franchise tax for the privilege of corporate existence within Alabama, but the base upon which the domestic tax is computed differs materially from the foreign franchise tax base. Specifically, the domestic tax is imposed solely on the amount of the domestic corporation's "capital stock," which means the aggregate par value of the domestic corporation's outstanding stock. ALA. CODE § 40-14-40 (1993) (App. G at 90a); *see* ALA. CONST. art. XII, § 229 (1901); *White v. Reynolds Metals Co.*, 558 So.2d 373, 374 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990). Because the Alabama Code permits do-

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[2] "App." references are to the various appendices bound with the Petitioners' Petition for a Writ of Certiorari to the Supreme Court of Alabama in *South Central Bell Telephone Co., et al. v. State of Alabama and State Department of Revenue*, No. 97-2045 (filed June 18, 1998).

mestic corporations to issue stock of low or no par value, those corporations may reduce their franchise tax liability to as little as $50 without changing their size, total capitalization, or the extent of their business activity within or without Alabama—any of which would affect an out-of-state corporation's tax liability. *See* ALA. CODE § 40-14-40 (1993) (App. G at 90a) (domestic franchise tax shall be no less than $50); Stip. Facts ¶¶ 21-23 (App. D at 52a-53a) (corporation may control amount of domestic franchise tax by assigning any value to par value or stated value of its capital stock).

Thus, whereas the domestic franchise tax is based on the par value of the corporation's outstanding stock (which may be legally manipulated by a domestic taxpayer), the foreign tax base includes not only that value, but also several items that are independently fixed—surplus, retained earnings, long-term and related-party debt, and accelerated depreciation.

As a result of the different tax bases, foreign corporations doing business in Alabama are subject to a substantially higher level of taxation than are similarly situated domestic corporations.[3] The trial court below accepted taxpayers' documentation that the Alabama franchise tax statutes in fact discriminate in favor of domestic corporations. (App. B at 21a n.7 & App. C at 34a-38a.) The study introduced by taxpayers determined that if domestic corporations had been subject to the franchise tax imposed on foreign corporations, the liability of the domestic entities would have been five times higher than it actually was. (App. C at 36a.) For example, the average percentage of discrimination in 1988 was 409.56 percent and in 1991, 509.15 percent. *Id.*

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[3] The domestic tax rate is $10 per $1,000 of capital stock while the foreign tax rate is $3 per $1,000 of capital employed, but the differential does not compensate for the vastly different tax bases.

The magnitude and consequence of Alabama's discrimination here are indisputable. Indeed, not one Alabama judge who reviewed the evidence in this case even intimated that the State's franchise tax scheme is constitutional. As the trial court conceded:

> [T]he Taxpayers' evidence in this action clearly and abundantly demonstrates that the franchise tax on foreign corporations discriminates against them for no other reason than the state of their incorporation. Accordingly, the Court finds that the franchise tax on foreign corporations violates the commerce clause of the Federal Constitution.

(App. B at 21a-22a) (footnote omitted). In spite of this finding of unconstitutionality, the trial court barred taxpayers from litigating the issue by virtue of its interpretation of *res judicata*. (App. B at 17a-19a, 22a.) A divided Alabama Supreme Court affirmed the decision without opinion. (App. A at 1a.)

II.

In this case, the trial court ruled that the taxpayers were precluded from litigating the constitutionality of the franchise tax because of the Alabama Supreme Court's prior decison in *White v. Reynolds Metals Co.*, 558 So.2d 373 (Ala. 1989), *cert. denied*, 496 U.S. 912 (1990). In reaching its conclusion that this action is barred by *res judicata*, the trial court below seriously misapprehended this Court's decision in *Richards v. Jefferson County*, 116 S. Ct. 1761 (1996). In doing so, it denied the taxpayers their federal due process rights. U.S. CONST. amend. XIV, § 1.

In considering the Alabama court's theory of *res judicata* here, the Court will no doubt experience an uncanny sense of *déjà vu*. In *Richards*, the taxpayers challenged the constitutionality of a county occupation tax on both state and federal grounds. The county

moved for summary judgment on the grounds that the taxpayers' claims were barred by a prior adjudication of the tax by a city director of finance. The trial court granted the county's motion on the state constitutional claims, but refused to do so on the federal claims, which had not been considered in the earlier case. On appeal, Alabama's highest court held that the federal claims were also barred.[4]

In its opinion in *Richards*, this Court unanimously found that Alabama's interpretation of *res judicata* "deprived [the taxpayers] of the due process of law guaranteed by the Fourteenth Amendment." 116 S. Ct. at 1765. In explaining this conclusion, the Court invoked the traditional rule that "extreme applications of the doctrine of res judicata may be inconsistent with a federal right that is 'fundamental in character.'" *Id.* (citation omitted).

Confirming that the "opportunity to be heard is an essential requisite of due process of law in judicial proceedings," the Court dismissed the Alabama court's conclusion that *res judicata* applied because the parties were adequately represented in the prior suit. 116 S. Ct. at 1765 n.4 & 1767. To have a binding effect on absent parties, the Court stated, a prior proceeding must at least be—

> so devised and applied as to insure that those present are of the same class as those absent and that the litigation is so conducted as to insure the full and fair consideration of the common issue.

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[4] The court reasoned that (i) the complaint in the earlier case had alleged that the county tax violated the Equal Protection Clause of the U.S. Constitution and an equal protection argument had been made in the briefs; (ii) the taxpayers in the prior case adequately represented petitioners because their respective interests were "essentially identical"; and (iii) the county had relied on the prior case in pledging tax revenues and issuing bonds. *Richards v. Jefferson Cty.*, 662 So.2d 1127, 1130 (Ala. 1995), *rev'd*, 116 S. Ct. 1761 (1996).

Id. at 1767 (quoting *Hansberry v. Lee*, 311 U.S. 32, 43 (1940)). This requirement was absent in *Richards* for three reasons. First, the taxpayers did not sue on behalf of a class. Second, they did not assert any claim against or on behalf of a class or nonparties. And third, the judgment they received did not purport to bind taxpayers who were not parties to the litigation. 116 S. Ct. at 1767.

In this case, the trial court perpetuated Alabama's error in *Richards*. Specifically, the court misconstrued *Richards* as holding the application of *res judicata* improper only because the petitioners did not receive notice of the prior litigation and were not sufficiently represented in that case. (App. B at 18a.) The trial court averred that the taxpayers here are "large and sophisticated" corporations "well informed in all matters involving issues of national and state taxation and . . . well informed of significant pending legal actions and court decisons." *Id.* Because the taxpayers were aware of the *Reynolds Metals* case at the time it was being litigated and because the taxpayers in that prior case were represented by "well known and excellent counsel"—and, indeed, were represented by the same counsel—the court endeavored to lower the bar of *res judicata*, insisting its action did not violate the taxpayers' due process rights. (App. B at 19a.)

Although facile and somewhat beguiling, the trial court's decision does not withstand scrutiny. Not only did the court exaggerate the extent and significance of the overlap of counsel in *Reynolds Metals* and the instant case, but its reasoning is strained.

First, although it is true that one of the petitioners' counsel represented the taxpayers in the *Reynolds Metals* case, the attorney's involvement in the earlier case was limited to seeking a writ of certiorari in this Court. In other words, he did not represent the taxpayers before the Alabama courts. More fundamentally, the Alabama trial court here misunderstands the core purpose of *res judi-*

cata. The doctrine is intended to promote finality and judicial economy by precluding the relitigation of issues where the parties in interest had previously enjoyed "their day in court." *See Commissioner v. Sunnen*, 333 U.S. 591, 597 (1948) (federal tax case). Even assuming the taxpayers here had knowledge of the *Reynolds Metals* case (and the record confirms that they did not become aware of the earlier case until after the trial court's decision [5]), the court's assumption that interstate businesses can and should keep track of all cases *potentially* affecting them is at once preposterous and perverse. Under the court's rationale, corporate taxpayers would be forced to follow hundreds, if not thousands, of state tax cases to which they were not parties. The decision would require an adequate, cost-effective, and time-sensitive tracking system—which, in fact, does not exist. Indeed, in many jurisdictions, trial court jurisprudence is not even published, and the only way a taxpayer could know about such cases would be to travel perpetually from courthouse to courthouse, reviewing every complaint and other pleading lodged in a case. Even for published decisions, taxpayers would need actual notice of every case. It is hard to believe such a clog in interstate commerce is constitutionally acceptable. *See Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

Even more troubling, the Alabama decision implies that taxpayers should stand ready to intervene in any case tangentially affecting their interests in order to preserve their rights. As an organization dedicated to minimizing the costs and burdens of tax administration to the common benefit of government and taxpayers, *amicus* TEI is astonished that such an impractical suggestion might be seriously made. The courts, too, should be concerned about the flood of protective interventions that would severely bog down the civil trial process. In other words, rather than serving the goal of judicial economy, the lower court's application of *res judicata* would thwart it.

[5] App. F. at 69a-70a, 73a-74a.

Moreover, *amicus* TEI is concerned about the practical effect of the trial court's imposing a more stringent standard on "large and sophisticated" taxpayers who employ "well known" counsel. Will large corporations be forced to plead unsophistication about tax matters in order to safeguard their right to dispute unconstitutional taxes? That their advisers are not well known? Will all large corporations be assumed in privity with one another and to share the same concerns, even though circumstance shows that often not to be the case? Will small, but sophisticated corporations be subject to the same standard? *Amicus* TEI submits that the size and sophistication of corporate taxpayers, as well as employment of experienced counsel, should be wholly irrelevant to the assertion—and vindication—of constitutional rights against discriminatory taxation.[6]

Without a doubt, a central principle of Anglo-American jurisprudence is that "one is not bound by a judgment *in personem* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process." *Hansberry*, 311 U.S. at 40. This rule, which is part of our "deep-rooted historic tradition that everyone should have his own day in court," *Martin v. Wilks*, 490 U.S. 755, 762 (1989) (citing 18 C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE ¶ 4449, at 417 (1981)), is threatened by the decision below. Indeed, that decision mocks the rule that a judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers. 490 U.S. at 762.[7]

[6] Alabama's own case law holds that the doctrine of *res judicata* should be used sparingly to preclude judicial review in tax cases involving different years. *Alabama v. Plantation Pipe Line Co.*, 89 So.2d 549, 569 (Ala.), *cert. denied*, 352 U.S. 943 (1956). This is particularly true for cases involving different tax years *and* different taxpayers. *See Richards*, 116 S. Ct. at 1768.

[7] The State's reliance (Br. in Op. at 6) on a footnote in *Martin v. Wilks*, asserting that there are exceptions to this general rule,

As the Court explained in *Richards*, "to contend that the plaintiff in [the prior litigation] somehow represented petitioners, let alone represented them in a constitutionally adequate manner, would be 'to attribute to them a power that it cannot be said that they had assumed to exercise.'" 116 S. Ct. at 1768 (quoting *Hansberry*, 311 U.S. at 46). The doctrine simply does not apply when superseding decisions of this country's highest court have repudiated the basis for the original decision. *Sunnen*, 333 U.S. at 599 (*res judicata* or estoppel by judgment "is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers"). The decision below represents another extreme application of *res judicata* in violation of the Due Process Clause. It should be reversed.

III.

The Commerce Clause of the Constitution provides that "Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . ." U.S. CONST. art. I, § 8, cl. 3. The clause not only provides Congress with broad regulatory powers, but also embodies a negative command forbidding States from discriminating against interstate

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is misplaced. *See* 490 U.S. at 762 n.2. In that case the Court identified three situations in which nonparties may be bound. First, the Court named class actions as being capable of binding "strangers" to litigation. The petitioners' challenge to the Alabama franchise tax is not such an action. *See Richards*, 116 S. Ct. at 1768. The second class of cases identified involved the control of litigation in behalf of one of the parties to the litigation. There is no such control here. Mere knowledge of the claim—if it existed here—is surely insufficient. *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 110 (1969) (judgment against parent corporation of a party properly vacated because it was not named as a party or served, even though it clearly knew of the claim and had made a special appearance to contest jurisdiction). Finally, the Court in *Martin v. Wilks* said nonparties might be bound where there is a special remedial scheme, as in bankruptcy or probate cases. That, however, is not the case here. 490 U.S. at 762 n.2.

commerce. *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 98 (1994). Its fundamental purpose "is to assure that there be free trade among the several States." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 335 (1977). To effectuate this purpose, a state taxing scheme will be invalidated if it imposes a higher tax burden on foreign corporations than on domestic corporations engaged in comparable activity. *Id.* at 329 ("[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects" [citations omitted]); *see Maryland v. Louisiana*, 451 U.S. 725, 754 (1981); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72-74 (1963). Moreover, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), this Court held that the presence of either a discriminatory purpose or a discriminatory effect justifies a finding of proscribed "economic protectionism." *Id.* at 272-73. Justifications for discriminatory restrictions on commerce must pass the strictest scrutiny. *Oregon Waste Systems*, 511 U.S. at 101.

In *Reynolds Metals*, the Alabama Supreme Court opined that the State's franchise tax scheme did not violate the Commerce Clause. In rationalizing its conclusion, the court cited several reasons for imposing foreign and domestic franchise taxes on different bases:

> ease of regulation and enforcement, differences in the utilization of state natural resources between foreign and domestic corporations, and differences in the employment of state residents and utilization of state services between foreign and domestic corporations.

558 So.2d at 389. The court in *Reynolds Metals* also blithely cited statements by the Chief of the Franchise Tax Division of the Alabama Department of Revenue that foreign corporations could reduce the amount of their franchise tax liability "merely by forming domestic corporate subsidiaries to do business in this state or by be-

coming Alabama corporations themselves." *Id.* at 384. To suggest such a burdensome course of action, however, is to miss the point of the Commerce Clause: Taxpayers should not be forced to jump through the hoop of domesticating their business activities or establishing subsidiaries in every State in order to avoid discrimination.[8] *See Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 505 U.S. 71, 78 (1992).

Indeed, that Alabama's franchise tax does not pass constitutional muster was made manifest by this Court's decision three terms ago in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), in which a North Carolina intangibles tax on the fair market value of stock owned by state residents was scrutinized and found wanting. Although the tax was assessed at a stated rate, residents could calculate their tax liability by taking a deduction equal to the fraction of the issuing corporation's income subject to tax in North Carolina. Thus, whereas taxpayers owning stock in a corporation that earned income solely within the state paid no intangibles tax, taxpayers with stock of foreign corporations having no in-state activities paid the full amount. Because the tax was computed on a different net base depending on the corporation's in-state activities, it facially discriminated against interstate commerce. 516 U.S. at 327-28, 333 & n.3. The same facial discrimination against interstate commerce marks the Alabama franchise tax. (App. A at 12a.)[9]

[8] Indeed, even assuming that it would be constitutionally permissible to require taxpayers to establish a separate subsidiary in every State, that option might not be available to some businesses. For example, a transportation company whose assets and employees move across state lines would find it impossible to operate in interstate commerce through a series of domesticated subsidiaries.

[9] Even before *Fulton Corp.*, the Alabama state court's rationale was suspect. In *Reynolds Metal*, the Alabama court erroneously equated the standards under which equal protection and Commerce Clause challenges are to be judged. In point of fact, two very different and distinct standards are to be applied: Whereas a statute may withstand attack on equal protection grounds where a classification is "rationally related to [a legitimate state] purpose," *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 881 (1985), the Commerce Clause proscribes *all* taxes that discriminate against interstate commerce, without regard to whether they are rationally related to a state purpose, *Maryland v. Louisiana*, 451 U.S. at 760. *See also Halliburton Oil Well Cementing Co.*, 373 U.S. at 73 ("we see no reason to depart from the strict rule of equality"); *Bacchus Imports*, 468 U.S. at 273 ("it is irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers").

Moreover, the tax cannot stand as a compensatory levy designed simply to make interstate commerce bear a burden already borne by intrastate commerce. Under the compensatory tax doctrine, a facially discriminatory tax that imposes on interstate commerce the equivalent of an "identifiable and substantially similar tax on intrastate commerce does not offend the negative Commerce Clause." *Oregon Waste Systems*, 511 U.S. at 103 (internal quotation marks omitted). There are three conditions for finding that a facially discriminatory tax is compensatory. First, a State must identify the intrastate tax burden for which the State is attempting to compensate. Second, the tax on interstate commerce must be shown roughly to approximate—but not exceed—the amount of the tax on intrastate commerce. Finally, the events on which the interstate and intrastate taxes are imposed must be substantially equivalent; that is to say, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other. *Fulton Corp.*, 516 U.S. at 332-33.

Like the intangibles tax in *Fulton Corp.*, the Alabama franchise tax cannot survive under the guise of a compensatory tax. Under the Alabama statutes, domestic corporations pay a 1 percent tax on their capital stock, while foreign corporations pay a 0.3 percent tax on capital employed within the state. ALA. CODE §§ 40-14-40, 40-14-41 (1993) (App. G at 90a-97a). That the State failed to meet its burden of showing that the foreign

franchise tax approximates the domestic tax or is substantially equivalent to other state taxes was confirmed by the well-reasoned dissent below:

> It is not facially apparent that application of the foreign franchise tax rate (0.3%) to the much larger base of par value plus other items such as surplus and long-term debt merely equalizes the burden produced by the application of the domestic franchise tax rate (1%) to the easily manipulable base of par value. . . . [T]he Taxpayers offer substantial evidence supporting the proposition that the foreign franchise tax exceeds any intrastate burden. . . . The State also fails to show that the events taxed by Alabama's intrastate taxes and the interstate tax are "substantially equivalent."

(App. A at 12a-14a) (See, J., dissenting). This finding is not at all surprising since "actual discrimination, wherever it is found, is impermissible, and the magnitude and scope of the discrimination have no bearing on the determinative question whether discrimination has occurred." *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 650 (1994) (citations omitted).

Let there be no mistake: In light of *Fulton Corp.*, the Alabama Supreme Court did not dispute that the Alabama "franchise tax facially discriminates against interstate commerce, and arguments over the degree of discrimination do not affect this characterization." (App. A at 13a) (See, J., dissenting). Rather, that court hid behind a lower court opinion conceding the tax's discriminatory nature but denying taxpayers' constitutional right to contest it on the grounds of *res judicata*. One compelling inference to be drawn from the Alabama Supreme Court's aversion to reaching the merits of the statute is that it recognized the futility of that inquiry under the Commerce Clause. As the Court explained in *Fulton Corp.*, "[s]tate laws discriminating against interstate commerce on their face are 'virtually *per se* invalid.'" 516 U.S. at 331 (citations omitted). *See also Oregon Waste*

Systems, 511 U.S. at 104 (1994 decision holding that the failure to identify a specific charge on intrastate commerce equal to or exceeding charge on interstate commerce is fatal to State's claim).

What is now clear—if there was ever any doubt—is that the Commerce Clause does not sanction *any* discrimination, regardless of magnitude or intent. As the Court noted in *Maryland v. Louisiana*, 451 U.S. at 760, "We need not know how unequal the Tax is before concluding that it unconstitutionally discriminates." Alabama's unequal tax at issue here must likewise fall.

IV.

The State of Alabama is in an unenviable position. Having discriminated against interstate commerce for years, the State finds itself confronted with the reality that its franchise tax scheme is unconstitutional, but also unable (or unwilling) to rectify the situation. Faced with the choice of crafting a meaningful remedy or of conjuring up a justification for denying the teachings of both *Fulton Corp.* and *Richards*, the court below disappointingly embraced the latter course. Indeed, the State employed Jabberwockian logic to apply *res judicata* in a manner that makes sense only if you do not think about it. Unfortunately for the State, the difficulty of fashioning an effective remedy—of placing the parties in roughly the same position they would have been in had their constitutional rights not been compromised—is not license to escape a situation of its own making.

The last 15 years have seen the States propound many an original and unfounded argument to deny taxpayers relief. This Court has rightly shown patience in permitting the States time to rectify their mistakes.[10] Some

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[10] *See National Private Truck Council, Inc. v. Oklahoma Tax Commission*, 115 S. Ct. 2351, 2354 (1995) ("principles of federalism

States, however, have taken advantage of the deference accorded them, either by improperly seeking to apply the Court's holdings on a prospective-only basis or by construing the States' refund statutes to render Pyrrhic the taxpayers' constitutional victory.[11] Alabama's strained approach here—donning judicial blinders to deny taxpayers access to a forum to press their righteous claims—represents a new tack, but it too should fail as inconsistent with federal due process principles.

The record in this case establishes that Alabama, while recognizing the dubious vitality of its decision in *Reynolds Metals*, will cleave to it until it is directly overturned, despite the clear mandate of this Court's intervening decisions.[12] It is not for a lower court, however, to pick and choose which decisions of this Court it will follow. *Quill Corp. v. North Dakota*, 504 U.S. 298, 321 (1992) (Scalia, J., concurring). *Accord The Mayor v. Cooper*, 73 U.S. (6 Wall.) 247, 253 (1867) (if the lower court did not adhere to Supreme Court precedent, there would be "mischievous consequences").

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and comity generally counsel that courts should adopt a hands-off approach with respect to state tax administration").

[11] *See, e.g., Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993) (retroactivity of Supreme Court case declaring tax unconstitutional); *Reich v. Collins*, 513 U.S. 106 (1994) (tortured use of Georgia statute to deny refunds of unconstitutional taxes); *Newsweek v. Florida Dep't of Revenue*, 118 S. Ct. 904 (1998) (vacating a decision of the Florida Supreme Court barring the taxpayer from pursuing a refund claim).

[12] *See, e.g.*, Judge Maddox's concurring opinion in the court below:

> [A]lthough I realize that the Supreme Court has released some opinions that could be interpreted as indicating a change in that Court's view of the constitutionality of state taxes such as that at issue in this case, the fact remains that the Supreme Court refused to review this Court's decision in *Reynolds Metals*, and that, as of today, *Reynolds Metals* remains the law.

(App. A at 6a.)

In this case, the Supreme Court of Alabama embraced a bogus theory of *res judicata* to deny taxpayers a refund of illegally extracted monies. If Alabama's judicial alchemy succeeds, state courts will become Wonderland, a place where the rules no longer matter. If taxpayers win by the rules, the States—like the Queen of Hearts in her game of croquet—will consider themselves free to change them.[13] The stakes here, however, are much greater than those encountered in a fanciful game of croquet. Accordingly, the Court should end its willing suspension of disbelief concerning the State's commitment to protect the constitutional rights of business taxpayers and thereby vivify the core values of the federal system and the Supremacy Clause.

Stated simply, the purpose of the Due Process Clause is to protect constitutional rights against arbitrary actions by the government, but what is more arbitrary than using distended legal principles to deny an opportunity to be heard? In *Richards*, this Court admonished Alabama against distorting the doctrine of *res judicata* to prevent taxpayers from seeking redress of wrongs in a court of law. But the courts below did not hear, and the distortions regrettably continue. It is obvious that the Court "cannot leave to the States the formulation of the authoritative laws, rules, and remedies designed to protect people from infractions by the States of federally guaranteed rights." *Chapman v. California*, 386 U.S. 18, 21 (1967). Alabama's attempt to deprive taxpayers of their rights should be stopped.

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[13] *See* Lewis Carroll (Charles L. Dodgson), *Alice's Adventures in Wonderland*, ch. VIII (1865) (The Queen's Croquet-Ground).

CONCLUSION

For the foregoing reasons, the Court should reverse the decision below and remand the case for a refund of the unconstitutionally collected taxes.

Respectfully submitted,

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